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Work Smarter, Not Harder: Towards Efficient Naval Financial Management

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Abstract

We explore the primary drivers of the United States Navy's financial management difficulties and propose feasible solutions to remediate these issues. Our hope is that financial managers at all levels of the public sector will find our suggestions useful to craft more efficient and effective FM practices.

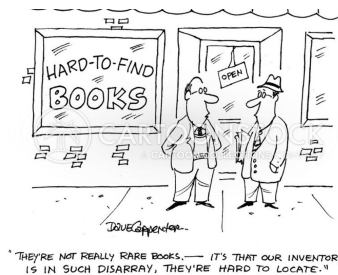
*"[Ernst & Young's] audit resulted in a disclaimer of opinion. EY could not obtain sufficient, appropriate audit evidence to support the reported amounts within the [Department of the Navy] Working Capital Fund Financial Statements. As a result, EY could not conclude whether the financial statements and related notes were presented fairly in accordance with Generally Accepted Accounting Principles."*ⁱⁱ

Auditors issue a disclaimer of opinion when a lack of audit evidence suggests that overlooked misstatements may be both material and pervasive in nature.ⁱⁱⁱ In *Using Disclaimers in Audit Reports*, Robert R. Davis documented a general downward trend in the pervasiveness of disclaimers of opinion and found that disclaimers in the late twentieth century were generally related to going concern issues of the audit entity.^{iv} In 2021, disclaimers remain rare, suggesting that only the most egregious of circumstances lead auditors to reach such a conclusion (or lack, thereof) in their report. Unfortunately, the United States Navy (and the wider Department of Defense, or DoD) finds themselves in this untenable position.

In this article, we explore the financial management challenges facing the Department of the Navy (DoN) and, by extension, the DoD, and, and we propose solutions the DoN can implement to redress their financial management (FM) difficulties. More importantly, the remedies we suggest are all predicated on the assumption that smarter spending, not *more* spending, can facilitate DoN's transition to an optimally functioning financial management unit. Given the economic pressures and resultant shrinking budgets the global COVID pandemic has created across the public sector, we hope our suggestions will be useful to financial managers at all levels of government.

The problem

Ernst & Young's (EY's) report on the Navy's internal controls over financial reporting identified eleven material weaknesses related to shortcomings in the existence, completeness, and veracity of various financial statement accounts including inventory and property, plant, and equipment.^v These deficiencies raise the real possibility that Naval management will not detect or correct financial reporting deviations in a timely manner, threatening the validity of reported figures. In the governmental arena, the financial reporting system and its outputs inform daily decision-making at the highest levels of an organization and also provide accountability with regard to the expenditure of taxpayer dollars.



Lack of oversight in the form of deficient internal controls threatens not only the Navy's ability to make efficient decisions but also undermines public trust regarding the manner in which tax dollars are spent.^{vi} The popular press reports and amplifies the extent of distrust in perceived wasteful defense spending. Elliott Negin reports that "...taxpayers spent \$13.34 trillion on the U.S. military from 2000 through fiscal year 2019 in inflation-adjusted 2020 dollars. Add to that another \$3.18 trillion for the Veterans Administration, and the yearly average comes to a whopping \$826 billion... There are plenty of reasons to cut the Pentagon's budget, but its track record of profligate spending is among the most obvious."^{vii}

The Navy's FM woes arise from three general areas: numerous, unintegrated financial reporting systems, redundant and often contradictory policies, and an overburdened, understaffed FM corps. The Navy currently uses multiple feeder systems for financial reporting; these systems are not integrated with one another and often do not directly feed the top-level general ledger. The agency recently consolidated to a single core financial system and general ledger for the Navy Budget Submitting Office, known as the Standard Accounting, Budgeting, and Reporting System (SABRS). When it comes to defense financial reporting, the right hand does not know what the left hand is doing and, more seriously, does not know that there is a left hand.

Excessive and redundant policies and procedures related to accounting exacerbate FM dysfunction. Naval regulations comprise 100 parts and 78 sections of the United States Code, with a corresponding proliferation in attendant policies.^{viii} These policies often impose more costs than they save.^{ix} For example, one author of this paper spent three hours filling out forms and justifying the need for a basic piece of office equipment. The price of the item? \$120. The

confusion profligate policies impose is humorous in the context of buying desks and chairs. When the items in question are critical (such as night vision goggles or parts needed for fleet maintenance), the distortions arising from unnecessary policies can mean the difference between mission success and failure. Compliance with attendant legislation is no small matter, a problem

Key Recommendations

Integrate. When in doubt, fewer accounting systems are better than many.

Deregulate. Excessive policies and procedures impose unexpected costs and reduce operational flexibility. Roll back unneeded legislation and don't replace it.

Concentrate. A functioning accounting system provides more accurate information for decision-makers and allows operational personnel to concentrate on their other responsibilities. FM requires and deserves a fully-dedicated corps rather than being added onto the duties of already overburdened leaders.

that is worsened by a shortage of FM personnel. In the field, a Commanding Officer or near subordinate becomes the default party responsible for complying with myriad policy-related restrictions while simultaneously engaging in their other duties. Although these personnel may be appropriately trained, it is unreasonable to expect one person to do two full-time jobs and excel at both. FM practices steadily fall down the list of priorities until they become a compliance exercise that is viewed as an impediment to the true duty of national defense.^x Having dispensed with the challenges, we now turn a more optimistic eye to the solutions.

Improving financial management

We recommend three steps the DoN and broader DoD can take to remediate some of the most pressing FM challenges they face. Our recommendations share the common advantage that they require *efficient* resource investments rather than *additional* resource investments. Although these suggestions are made in the context of the DoN's FM issues, they can be broadly applied outside the defense context to all levels of public sector FM.

First, we suggest the DoN eliminate excess accounting systems and integrate those that remain with each other and with the general ledger. The recent Navy-wide rollout of SABRS represents an important first step in this direction, and the initiative towards agency-wide consolidation should be expanded. Leading private entities use a sole accounting system that feeds a unique general ledger. While Naval FM systems face unique security vulnerabilities that private organizations do not share, financial managers can still learn from the best practices of industry. Deploying a single top-level reporting system and fully integrating the general ledger with feeder systems will prevent the need for ad hoc workarounds that result in a disconnect between the entity's actual activities and what is captured in the consolidated financial reports.

Just as enterprise accounting solutions should be streamlined, so should regulation. Excessive legislative guidance in the form of policies and procedures imposes significant costs at all levels of the Navy. As the above-enumerated example regarding equipment suggests, the plethora of regulations that currently surround FM-related activities often result in additional expenditures whose value exceeds any potential cost savings. In a perfect world, guidance would exactly anticipate the expected value of waste, fraud, abuse, and human error and would impose total costs less than the savings of preventing deliberate or unintentional malfeasance. In the world in which we live, policies generate unintended consequences. Moreover, they hinder the ability of FM professionals to exercise their judgment. When boots on the ground cannot apply their unique insights to the discharge of their responsibilities, it creates workarounds that distort financial reporting, leading to the sort of irregularities uncovered in the Navy's audit.

Finally, agencies who are serious about creating fully functioning FM systems that accurately capture the entity's activities and provide decision-useful information to internal leaders, legislators, and members of the public should invest in the creation of a dedicated FM corps. As previously mentioned, it is impracticable for operational personnel to also serve as financial managers. In addition to lacking the time to execute FM related duties, fully engaging with the FM process detracts from the time such individuals have to dedicate to their core mission, which is national defense, not debits and credits. Investments in FM leadership are likely to confer significant benefits on the entire Department, as transferring FM tasks to corresponding professionals will reduce the need for work arounds and ad hoc solutions that arise when operational personnel face an overabundance of tasks that no single mortal can reasonably complete in any given day. In addition to preventing reporting distortions, maintaining an FM corps will also facilitate mission readiness as operational personnel can transfer their attention to their core job functions.

At its best, accounting and financial reporting are management control systems that capture an entity's activities, facilitate wise decision making, and provide stewardship regarding the government expenditure of taxpayer dollars. At its worst, FM systems become a club to beat over the head of personnel. The Navy currently finds itself in the latter situation. By shifting attention away from what has failed and towards integration, deregulation, and concentration, the Navy can remediate its FM shortcomings and free up the attention of its personnel for the most important job function of all: national defense.

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ⁱⁱ Department of the Navy Fiscal Year 2020 Agency Financial Report, page 187. See <https://www.secnv.navy.mil/fmc/fmo/Documents/2020%20Annual%20Financial%20Report.pdf>.

ⁱⁱⁱ Statements on Auditing Standards 122 and 123

^{iv} Davis, R.R. 2001. "Using Disclosures in the Audit Report." *The CPA Journal*. (74)4: 26-29.

^v For example, EY reported that insufficient internal controls resulted in the DoN being unable to support the reported inventory balances in the Consolidated Financial Statements. See Department of the Navy Fiscal Year 2020 Agency Financial Report.

^{vi} Chan, J.L. 2003. "Government Accounting: An Assessment of Theory, Purposes and Standards." *Public Money & Management*. (23)1: 13-20.

^{vii} Negin, E. 14 September 2020. "It's Time to Rein in Inflated Military Budgets." *Scientific American*.

^{viii} See <https://open.defense.gov/Regulatory-Program/Rules/NavyRules/>.

^{ix} The anecdotes in this paper are taken from conversations with various FM personnel in the Navy.

^x We are not criticizing or blaming the many excellent FM professionals found at all levels of the DoD. Rather, we are highlighting that they are in an unsustainable position that contributes to the overall accounting issues identified in the DoN audit.